ACTUARIAL VALUATION

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THE GEPF STATUTORY VALUATION RESULTS AS AT 31 MARCH 2021

The GEPF recently published the statutory actuarial valuation report as at 31 March 2021. Actuarial valuation reports are quite detailed, long and difficult to understand for the layman. This article aims to summarise the content of the actuarial report and explain the results in a simplified manner.

The purpose of statutory actuarial valuation

As suggested by the name, a statutory valuation is required by regulation. The GEPF is Governed by the GEP Law and Rules. According to the GEP Law, the fund is required to submit a statutory actuarial valuation at least once every three years. Hence one of the purposes is to satisfy this regulatory requirement. **Though the report is meant to cover the aspects required by the GEP Law, there are additional disclosures included which are not requirements of the GEP Law. These are more aligned with the Pension Funds Act and are included in the valuation report as best practice.**

A valuation presents a good chance for the fund to assess its financial health. This is done by assessing whether the existing assets are sufficient to meet all the fund's obligations. The valuation also serves the purpose of assessing the level of employer contributions required in the future years as well as reviewing the level of additional reserves required to further protect members' benefits.

A glance at the valuation results

The fund reflected a healthy financial position as at 31 March 2021. A healthy financial position is one where the assets and investments of the fund are worth more than the fund's obligations. As at 31 March 2021, the fund's net assets were about R2.041 trillion compared to total liabilities of R1.854 trillion reflecting a surplus of around R187 million. This reflects a minimum funding level of 110.1% which is an improvement from the previous funding level of 108.3%. The funding level of 110.1% means that the fund has R110.10 set aside as assets for every R100 that it owes to its members.

The valuation report reflected a required employer contribution rate of 17.3% of pensionable salaries for Services members and 13.5% of pensionable salaries for other members. The contribution rate reflects what is needed to meet the benefits that members are expected to earn over the next two years, provided that all assumptions work out as expected.

Membership statistics

The valuation of the fund was based on an increased membership of 1 270 444 active members and 485 633 pensioners and beneficiaries. The pensionable salaries of members who contributed to the fund throughout the valuation period increased by an average of 6.2% per annum, during the valuation period.

Annual pensions increased by an average of 4.0% per annum during the valuation period. The employer contributed at 16% and 13% of pensionable salaries for services and other members respectively.

The valuation assumptions and why they are required

The GEPF is a defined benefit fund which means that the formula to determine the benefits payable to members when they leave the fund are prescribed. The fund does not guarantee the exact payment to be made at the point of exit. In addition, it is not possible to predict with certainty when exactly a benefit payment will be triggered and for how long the pension payments will be made for. Assumptions are then required to approximate these factors. Assumptions on how salaries and pensions will increase in the future are then required. These are referred to as salary and pension increase assumptions and form part of the economic assumptions. Assumptions relating to how likely members are to withdraw from the fund and how long they are expected to live for, are also required. These are referred to as the demographic assumptions.

It is important to note that the fund's obligation relates to the promise made to members to pay their pension benefits for life. This is a financial commitment and is based on benefits payable in the future.

There is a need to standardise these future payments in today's terms. To do this, we need to attribute a time value to money and express these future payments as a lump-sum value in today's terms. This is done by discounting all future cash flows using the discount rate assumption, which is part of the economic assumptions.
As you can see, the assumptions are required to estimate a value today of all the expected future benefit payments.

Why the assumptions change and why they are best-estimate

The economic assumptions are based on the long-term market expectations and conditions as at the valuation
date. As the assumptions are based on market expectation, these values change as market views and sentiments change. The assumptions provided by the market are referred to s best-estimate assumptions. Such assumptions allow for a long-term view of the market and take account of expected peaks and troughs and expects these effects to cancel each other out over time. These best-estimate assumptions are then used to determine the fund's liabilities. It is important to note that the best-estimate liabilities are expected to cover for all expected payments.

What has led to the improved minimum funding level?

The 2021 economic assumptions are higher than in 2018 and result in a wider gap between the discount rate and the salary /pension increase assumptions. This gap is the biggest driver of the liabilities. The higher the gap is, the lower the overall fund liability. The minimum funding level has improved mainly due

- to salary and pension increases being lower than allowed for in the previous projections
- to the wider gap between the discount rate and salary and pension incre ase assumptions for the current valuation,
- pension increases being higher than previously projected.

Though the investment returns were lower than expected
and the demographic assumptions were less favourable compared to expectations, this was not enough to outweigh the surplus generated by the above factors. The fund, therefore, experienced an increased surplus and reflected a higher minimum funding level.

The required employer contribution rates

Part of the disclosures of the valuation are the recommendations on the future contribution rates to be adopted by the employers going forward. The recommendation is based on the benefits that are expected to be earned by active members over the next two years, which in turn is based on the valuation assumptions adopted. The required employer contribution rate is equal to 17.3% of pensionable salaries for Services members and 13.5% of pensionable salaries for Other members. This is lower than the previously required rates of 18.9% and 14.4% of pensionable salaries for Services and Other members respectively.
The reduction in the required contribution rate is mainly due to the less stringent valuation economic assumptions adopted for the current valuation.

110.1%

What the long-term funding level represents

It is important to note that both the minimum and long-term funding levels look at the long-term position of the fund. The only difference is that the minimum funding level does not make an allowance for contingency reserves. Instead,
the minimumfunding level only considers the best-estimate liabilities, which are the funds set aside to cover for the expected future benefit payments. Contingency reserves are additional amounts that are set aside to cover unexpected events over a prolonged period. These events include

- prolonged periods of low economic activity and low returns; and
- prolonged mortality improvements resulting in pension payments being made for longer periods than expected.

The GEPF liabilities are of long duration and payments are expected to be made over a long period of time. It is highly unlikely that the fund would. Unlike the banking and insurance industries, pension funds are expected to withstand periods of depressed economic activity over the medium term. Furthermore, the GEPF has the government as a guarantor of last resort which adds further protection to members' benefits. This means that there is no strict requirement to hold contingency reserves in full. Holding the full contingency reserves is an ideal position but is not a requirement for the fund.

As previously mentioned, the fund is governed by the GEP Law, and the GEP Law does not make any allowance for contingency reserves. The fund reports on contingency levels to try mirror the Pension Funds Act ("PFA"), which is applicable to all other funds. However, even under the PFA, a fund is only considered to be in a deficit if its assets cannot meet the best-estimate liabilities only. This means that contingency reserves **are not allowed to put a fund into a deficit** and a fund would only be required to **hold the level of contingency reserves supported by its assets**. The contingency reserves should not be viewed as an additional obligation but should be viewed as an additional buffer that is set aside to cover unexpected events. The full recommended contingency reserves amounted to R892m. The fund's assets can support holding 20.9% of the full contingency reserves. This represents an additional buffer in addition to the amounts set aside to meet the best-estimate liabilities.

Summary

In summary, the fund is in a healthy financial position and has reflected an improved minimum funding level from the previous valuation. This fund can afford to meet all expected benefit payments in full and allow for a buffer of R187m to cover unexpected events. The recommended employer contributions rates have been reduced from the previous valuation due to the more favourable long-term assumptions. In closing, the fund is in a healthy position and aims to provide further protection for its members" benefits.

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